In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 1047

HOMER L. BRUCE, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The question presented is whether petitioner is entitled to mineral depletion allowances calculated in a manner not specifically authorized by statute. Petitioner owns shares in a trust which owns a number of oil and gas royalties. The trust periodically distributes its net income, and petitioner is entitled to a depletion deduction on his share of the trust's royalty income. For the years in suit petitioner originally elected to take the percentage depletion deduction of 27½ percent authorized by § 613 of the Internal Revenue Code of 1954. His only statutory alternative, discussed below, would have been to claim cost depletion, computed as authorized by §§ 611 and 612 of the Code.

259-995—67

tions.[2] As it is, he is authorized to take the substantial annual deduction of 27½ percent of his adjusted gross income from mineral production—as he originally elected to do.[3] No other form of depletion allowance is sanctioned by the governing statutory provisions.

Petitioner's contention that he is entitled to a form of depletion allowance not authorized by Congress is based upon a confusion of concepts, well illustrated by his mistaken assertion (Pet. 11) that *Burnet* v. *Logan*, 283 U.S. 404, "is in all essential respects identical with this case." *Burnet* v. *Logan* dealt with the question of computing the gain on the sale of a capital asset. Under the governing Code sections a taxpayer is entitled, of course, to offset his cost basis against gross proceeds and only the excess is taken into income as capital gain. The taxpayer in *Burnet* v. *Logan* had sold her stock for a consideration consisting mainly of wholly-speculative contingent future payments, the total of which might well not equal her capital investment. The Court held that the sale was not a closed transaction and that the taxpayer was entitled to exclude the payments from gross income until her cost basis was recovered. In so holding this Court made it clear that its decision had no application to depletion deductions, saying (283 U.S., p. 412): "We are not dealing with royalties or deductions from gross income because of depletion of mining property." In the mineral depletion area Con-

[2] Cf., *e.g.*, *Commissioner* v. *Indiana Broadcasting Corp.*, 350 F. 2d 580 (C.A. 7), certiorari denied, 382 U.S. 1027.

[3] See *F.-K. Land Co.* v. *Commissioner*, 90 F. 2d 484 (C.A. 9).

gress has provided a detailed system of percentage depletion deductions for those cases where cost depletion either cannot be calculated or is inadequate. Thus, the rationale of *Burnet* v. *Logan* is inapplicable.[4]

Moreover, even if the *Logan* case were applicable in the depletion area, it applies only where the value of the taxpayer's interest is wholly speculative so that there is no way of estimating whether he can or will ever recover his investment. In the instant case petitioner's interest in the trust has an established market value which is far in excess of his cost basis (Pet. 31); additionally, the lower court found that if petitioner retained his trust interest, his total royalties would exceed his investment and concluded that, contrary to petitioner's argument, the allowable percentage depletion deductions may well exceed his investment (Pet. 29, 31). Therefore, *Burnet* v. *Logan* could have no application to the facts of this case. Since petitioner's total royalties will exceed

[4] Petitioner cites three early rulings by the Internal Revenue Service (1931–1933) for the proposition that *Burnet* v. *Logan* can apply to royalties (Pet. 12). But none of these rulings holds that a taxpayer *who qualifies for depletion deductions* may, in lieu of computing depletion under the specific Code sections (the predecessors to 1954 Code §§ 611–613), first receive tax free an amount of royalties equal to his cost basis. G.C.M. 9798, X–2 Cum. Bull. 221 (1931), specifically states that it is dealing with a taxpayer who was receiving royalty payments *which did not qualify for depletion deductions*. G.C.M. 11473, XII–1 Cum. Bull. 91 (1933), dealt with insurance renewal commissions rather than mineral royalties. And G.C.M. 11822, XII–1 Cum. Bull. 229 (1933), merely states the result reached in G.C.M. 9798 as an incidental part of the background for resolving a different question.

his capital investment, his theory—if accepted—would allow him first to recover his entire investment tax-free and thereafter to claim percentage depletion on all additional royalties received.

Petitioner is entitled to claim percentage depletion for each year in which he cannot make a reasonable estimate of future production; then in later years when he is able to make a reasonable estimate of remaining future production, he may use cost depletion to write-off any undeducted investment.[5] In this way his total depletion deductions will at least equal his investment.[6]

2. Petitioner also argues that if he is not entitled to greater *depletion* deductions than the Commissioner has allowed, he must be entitled to take *depreciation* deductions with respect to (1) the shares he owns in the trust and (2) the shares the trust owns in Trinity Petroleum Inc. The trust's assets consist solely of mineral interests owned outright and stock in Trinity

[5] A taxpayer is free to switch back and forth between cost and percentage depletion, from year to year depending upon which method produces the greater deduction. 1954 Code § 613(a).

[6] For example, if a taxpayer has an investment of $100,000 and during the first ten years of production he receives $150,000 in royalties, he would be entitled to $41,250 of percentage depletion (27½% of $150,000). If he then, for the first time, is able to make a reasonable estimate of future production, and his estimate showed that the remaining oil would be exhausted ratably over the next three years, he would be entitled to deduct his remaining basis of $58,750 ($100,000 less $41,250) ratably over the three years, even if these deductions exceed his income from the well in those years.

Petroleum Inc., a corporation which owns mineral interests. As to the mineral interests owned directly by the trust, petitioner's sole method for recovering his capital investment is depletion, not depreciation deductions (see *Von Baumbach* v. *Sargent Land Co.*, 242 U.S. 503, 524), and, as discussed above, petitioner is claiming the maximum depletion allowed by law.

As to the stock in Trinity Petroleum Inc., it has long been established that corporate stock is by its very nature a non-depreciable asset. See *United States* v. *Georgia Railroad & Banking Co.*, 348 F. 2d 278 (C.A. 5); *Exposition Souvenir Corp.* v. *Commissioner*, 163 F. 2d 283, 285 (C.A. 2); 4 Mertens, Law of Federal Taxation, § 23.49. Petitioner's reference to *New York Life Insurance Co.* v. *Anderson*, 263 Fed. 527 (C.A. 2), as supporting depreciation deductions for corporate stock is misplaced. In that case the Second Circuit held that the Corporate Tax Act of 1909 permitted a deduction for the decline in the market value of securities held by the taxpayer. A short time thereafter the same court held that the Revenue Act of 1913—the relevant portions of which are substantially the same as the provisions here in question—did not allow a deduction for "the depreciation [in value] of securities, which had not been sold during the year" (*New York Life Insurance Co.* v. *Edwards*, 8 F. 2d 851, 858), and this Court affirmed on that point (271 U.S. 109, 116). The point is now well settled. See *New York Life Insurance Co.* v. *Edwards, supra; G. E. Employees Securities Corporation*

v. *Manning*, 137 F. 2d 637, 641, 642 (C.A. 3); Treas. Reg. § 1.165–4.[1]

The petition for a writ of certiorari should be denied.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.
MITCHELL ROGOVIN,
Assistant Attorney General.
GRANT W. WIPRUD,
THOMAS L. STAPLETON,
Attorneys.

APRIL 1967.

[1] Even if corporate stock qualified as a depreciable intangible asset, petitioner would have the burden of proving that it had a "limited" useful life, "the length of which can be estimated with reasonable accuracy" in order to obtain a depreciation deduction. Treas. Reg. § 1.167(a)–3; see also, *e.g.*, *Commissioner* v. *Indiana Broadcasting Corp.*, 350 F. 2d 580 (C.A. 7), certiorari denied, 382 U.S. 1027. Not only has petitioner failed to do this, but the core of his depletion argument is that it is impossible to estimate the life of the mineral reserves in question (Pet. 8).

U.S. GOVERNMENT PRINTING OFFICE: 1967